FX Daily: Headline-driven trading continues

The dollar continues to be bounced around by the latest headlines on the war in the Middle East. Traders will be eager to hear, particularly from the Iranian side, whether there is any realistic chance of ceasefire negotiations getting started. Until then, any further rally in risk assets and sell-off in the dollar will prove limited

USD: Probably near the top of the range

The dollar sold off yesterday on comments from President Trump that negotiations had started with the Iranian regime. Sources in Iran denied that any such activity was taking place. The fact that the dollar has stayed soft over the last 24 hours probably represents the view that Washington is increasingly looking for an off-ramp to this crisis. The Strait of Hormuz remains shut and despite the US being a net energy exporter, US gasoline prices have surged 30% to near $4.00 per gallon, the S&P 500 is off 5%, and US ten-year government borrowing costs are up 40bp.

Iran has leverage with the Strait of Hormuz, however. For another big leg higher in risk assets to occur, we probably need to hear something positive from the Iranian side. News from the US that envoys are being sent for negotiations in Pakistan may not be enough to trigger another significant drop in the dollar.

Beyond the inevitable set of Middle East headlines today, the US macro focus will be on the weekly ADP jobs report (any job losses yet?), and the provisional March PMI releases. It may be a little too early for the PMIs to come lower, but clearly an energy supply shock will inevitably take its toll on business sentiment.

DXY has recently stalled at the top of the nine-month range near 100.25/50. We think its medium-term upside is limited unless energy prices make another major move higher or challenges emerge in financial plumbing, such as the cross-currency basis swaps moving wider (briefly seen yesterday) as banks use the FX swap market to secure dollar funding in wholesale markets.

99.00-100.00 may be the near-term range until we see the next decisive chapter in this Middle East conflict.

Chris Turner

EUR: Doubts emerge about an April ECB hike

President Trump's comments in the late European morning yesterday quickly saw the market cut the chances of an April ECB rate hike to 65% from 100%. Our macro team, at this stage, feel a hike in April is very unlikely. However, it does not cost much for the ECB to talk tough, souring this supply shock in an effort to keep inflation expectations in check. On that subject, the ECB releases its survey on one-year and three-year inflation expectations this Friday – although this is for February.

For today, the focus will be on the flash March PMIs for the eurozone, Germany and France. A lot of these are expected to dip back under 50 as businesses struggle to deal with higher energy prices and weaker domestic demand.

EUR/USD has short-term resistance at 1.1610 and 1.1670. We struggle to see EUR/USD breaking above the latter level unless there is positive news on negotiations emerging from Iranian sources.

Chris Turner

GBP: Staying surprisingly bid

Even though UK short-dated interest rates had some of the biggest adjustments lower yesterday, EUR/GBP remains surprisingly offered. Clear support is defined at the 0.8600/8620 area, which we – and probably the rest of the market – expect to hold. That is the same for the FX option market, where the EUR/GBP one-month risk reversal – or the price of a call option over an equivalent put option – remains bid at its recent highs of 0.8%.

Our UK economist also feels the bar is exceptionally high for the Bank of England to hike the already restrictive policy rate, and it may well be that softer activity data takes some of the sting out of BoE tightening expectations.

A big drop in some of the March flash UK PMIs today could weigh a little on sterling, although we should be wary of comments from Bank of England arch-hawk, Huw Pill, at 1430CET today. He could well say he plans to vote for an April hike.

Our baseline assumes 0.8600/8620 does contain EUR/GBP downside.

Chris Turner

ZAR: Slow recovery for the rand

After a near 10% correction higher in USD/ZAR over the last month, we doubt investors will be so quick to jump back into the rand story. The surge in energy prices has triggered a 100bp hawkish turnaround in expectations of the South African Reserve Bank policy path for the next 12 months, and reversed the strong portfolio flows into the local currency bond market. The huge correction lower in gold prices, as well as the surge in energy prices, have also delivered a major deterioration in South Africa's terms of trade.

USD/ZAR may now struggle to break back under its 100-day moving average near 16.50/55 unless there is a massive reversal lower in energy prices and some earlier Fed easing is back on the table.

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